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SUBJECT: FRENCH GDP GROWTH REMAINS MODERATE

REF: (A) Paris 2741

11. SUMMARY: In its June overview, the National Statistical Agency INSEE forecast French GDP growth to increase 2.1 percent in 2007 compared to 2.2 percent in 2006. It stressed that GDP growth would reach 2.5 percent in Q-4 over Q-4 2006 due to solid household consumption. INSEE confirmed that the tax package proposed by the President would have moderate impact on 2007 GDP growth. END SUMMARY

#### GDP Forecast to Increase 2.1 Percent

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12. INSEE, the French national statistical agency, forecast GDP growth in France will accelerate from a disappointing 2.0 percent (annualized; preceding year price basis) in Q-1 to 2.4 percent in Q-2 and 2.8 percent in each of Q-3 and Q-4, for an average of 2.1 percent in 2007, a slight dip from 2.2 percent in 2006. GDP growth would accelerate in the second half mainly due to solid household consumption, and run on a 2.5 percent pace in the fourth quarter compared to Q-4 2006.

#### Consumption Boosted by Household Purchasing Power

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13. A mild winter reduced household energy consumption energy in Q-1, while purchases of clothing decreased. The drag on GDP growth is estimated at 0.4 percent (annualized). INSEE forecast a catch up in Q-2, although consumption of manufactured products (a partial indicator of household consumption) decreased 0.8 percent in May after dipping 0.1 percent in April. INSEE predicts that household consumption should rebound in the second half of 2007, boosted by increased household purchasing power (3.2 percent compared with 2.4 percent in 2006). Improvement would be due to lower inflation (average of 1.2 percent compared with 1.6 percent in 2006, but at the end of the year, inflation would increase to 1.5 percent based on oil prices at 65 USD per barrel and an exchange rate of 1.35 USD per euro). Household consumption would be boosted by dynamic employment (300,000 jobs created compared to 256,000 in 2006) and a reduced tax burden (reftel). INSEE forecast the impact of the tax package on economic growth to be modest in 2007 since one of the major measures, the tax exemption on overtime work, would become effective only in October. INSEE says the impact of other measures which are already effective (tax cuts on mortgage interest payments) or which will become effective just after the law is passed during the summer (tax cuts on inheritances) will be modest. Consumption also reacts with a delay to tax cuts.

14. INSEE indicates that the unemployment rate should decrease by the end of the year, but does not propose any forecast, saying that in November it will participate in a meeting on employment data with the National Council of Statistical Information (CNIS).

Unemployment data have been at the center of debates in the last few months. INSEE says that the unemployment rate is currently close to 9.4 percent (versus GOF current estimate of 8.3 percent), but warns its latest estimate should not be considered official.

#### Investment and Export Growth Not Sufficient

15. INSEE forecast corporate investment continuing to rise moderately in 2007, up 5.4 percent compared to 4.6 percent in 2006. INSEE analysts said that export growth should slow at 3.1 percent compared to 6.0 percent in 2006, partially due to the impact of a strong euro. The forecast results in a positive 2.5 percent contribution of household consumption to GDP growth, while foreign trade would have a negative 0.3 percent contribution.

#### French GDP Growth Lags Behind Euro Zone

16. INSEE chief economist Eric Dubois commented "there will be no major change in the pace of French economic growth in 2007." The INSEE GDP forecast is marginally lower than the 2.2 percent OECD's estimate, below the 2.25-2.5 percent government forecast, and compares unfavorably with the 2.4 percent European Commission forecast. Forecasts show the French GDP growth lagging behind the 2.8 percent euro zone GDP growth in 2007.

#### Main Risks

17. The risk of a decline in real estate sector prices looks limited. However, INSEE does not rule out an increase in oil prices above 65 USD per barrel due to geopolitical factors and higher consumption. No details were provided on possible impacts on GDP growth.

#### COMMENT

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18. INSEE highlights the fact that its estimate is now based on preceding year prices, saying the new basis permits direct international comparisons and improves estimates of GDP components. It is no surprise that household consumption forecasts, based on the preceding year price, shows a 2.3 percent increase in 2007 (versus 2.8 percent in the 2000 price basis), household purchasing power is up 2.4 percent (versus 2.9 percent), and consumption of manufactured products growth looks much less solid (2.7 percent versus 4.3 percent). However, data regarding changes in inventories are no longer available; only contribution of inventories to GDP growth is available. Imports of goods and services do not add up. Ratios as a percent of GDP (e.g. investment as a percentage of GDP) are still based on estimates in current prices.

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